Lesson 3:
Payment Events, Event Completion Criteria, and Event Values

What We Will Learn

- How to successfully structure a contract to be financed through performance-based payments
  - Establishment of the milestone event schedule
  - Appropriate event values

FAR 32.1004 Procedures

- “The contracting officer must establish a complete, fully defined schedule of events or performance criteria and payment amounts when negotiating contract terms.”

FAR 32.1004 Procedures (cont'd)

- "If a contract action significantly affects the price, or event or completion criterion, the contracting officer responsible for pricing the contract modification must adjust the performance-based payment schedule appropriately."

Three Key Steps

- Establishing appropriate and verifiable payment events
- Accurately defining event completion criteria
- Determining commensurate payment event values

Requirements for Good Criteria

- Establishing appropriate performance-based payment criteria requires:
  - Thorough knowledge of product and processes required to build product
  - Coordination between customer and DCMA
  - Coordination between technical and business communities

Good Criteria Essential

- Good PBP criteria will ensure that:
  - Contractor receives adequate cash flow
    - Financing is limited to what is required for contract performance
  - Contractor performance is appropriately motivated
  - Contract completion is successfully achieved

The PBP Team Members

- Customer
- Contractor
- DCMA
- DCAA
- DFAS

DCMA Pre-Award Involvement

- Customers should involve DCMA during the pre-award phase
- If ACOs are aware of customers not including DCMA in pre-award phase of contemplated PBP financed contracts
  - Contact applicable DCMA Customer Liaison Representatives (CLRs) and solicit their assistance

FAR 52.232-28

- The terms and conditions of the performance-based payments must--
  - (i) Comply with FAR 32.1004;
  - (ii) Be reasonable and consistent with all other technical and cost information included in the offeror's proposal; and
  - (iii) Their total shall **not** exceed 90 percent of the contract price if on a whole contract basis, or 90 percent of the delivery item price if on a delivery item basis.

FAR 52.232-28 (cont'd)

- The offeror's proposal of performance-based payment financing shall include the following:
  - The proposed contractual language describing the performance-based payments
  - Listing of--
    - The projected performance-based payment dates and the projected payment amounts; and
    - The projected delivery date and the projected payment amount.
  - Information addressing the Contractor's investment in the contract

What Is a Payment Event?

- A PBP event is an activity that, when successfully completed during the performance of a contract, entitles the contractor to receive a performance-based financing payment

What PBP Event Represents

- A definitive milestone in path to contract completion
  - NOT something that simply “happens” along the way
  - Right item, Right time, Right price
- True value added
  - NOT merely effort expended

Integral and Necessary

- A PBP event need not be considered critical in order to be used to trigger payment but it must be an integral and necessary part of contract performance [FAR Subpart 31.1004(a)(1)]

Successful Completion

- Successful completion of event must be:
  - Readily measurable and verifiable
  - Identified in the contract with a detailed description of what constitutes successful performance of the event

How to Establish Payment Events

- Diagram the process flow of the product
- Identify the key events that lead to completion of the product
- Events must be structured on either a whole contract or line item basis

Few or Many?

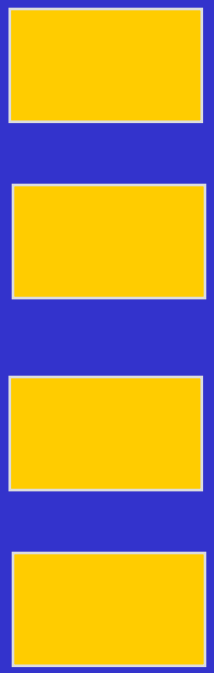
- There is no magic number
- Number of events should be selected to provide adequate cash flow for contractor while reducing administrative effort for both sides
  - More events are not necessarily better

Two Kinds of Payment Events

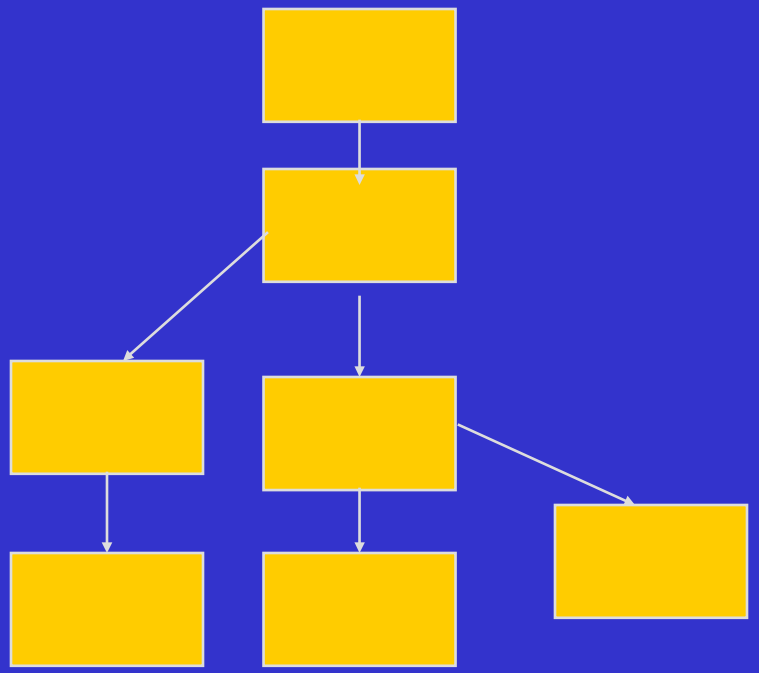
- PBP events may be severable or cumulative [FAR Subpart 32.1004(a)(2)]
- Contracts may include more than one series of severable and/or cumulative event criteria

Two Kinds of Payment Events (cont'd)

Severable Events



Cumulative Events



# of Good Payment Events

- Have clear milestones
- May represent a physical change in the product
- Indicate added value
- Not surrogates for incurred costs

Examples of Good Payment Events

- Receipt of material
- Product leaving fabrication
- Completion of first article testing
- Completion of a sub assembly
- Machining, forging, or fabricating parts

Inappropriate Payment Events

- Typical administrative actions
  - Ex: Signing of contract or modification
- Events that only indicate passage of time or incurring of costs
  - Ex: 6 months before delivery

Misconception

- **Monthly events are necessary to generate adequate cash flow to the contractor**

A limited number of PBP events provides the contractor a cash flow that is significantly more advantageous than that offered by Progress Payments.

Sample PBP Events For Aircraft

1 Rough Machining of MLG Bulkhead Frames

2 Receipt of Aft Pressure Bulkhead Details

3 Completion of Wing Spars

Cumulative Assembly Series

4 Completion of Wing Halves

5 Completion of Four Major Sub-Assemblies

6 Completion of Final Assembly

***Aircraft Delivery** – Delivery <u>not</u> a PBP event. All PBPs are liquidated by deducting them from delivery payment.

Class Activity 1

Payment for the contract price of CLINs 0001-0004 shall be made to the Contractor in accordance with the following payment schedule:

PAYMENT EVENT	PERCENT OF CLIN PRICE	CUMULATIVE PERCENT
PAYMENT EVENT 1: Aircraft Enters Paint	75%	75%
PAYMENT EVENT 2: Acceptance of Aircraft (DD 250)	25%	100%

Class Activity 2

- Completion of a payment event will be demonstrated by achievement of the criteria (shown below)
- ACO will verify completion of the specific event
  - Using on site physical inspection, and/or
  - Contractor's manufacturing reports
  - In such detail as requested

Class Activity 3

- Description of payment event completion criteria.

  Payment No. 1- Aircraft enters Paint. This event is complete when aircraft assembly requirements have been completed at Aircraft Production Flow-Position One (1), per the Contractor's Major Assembly Sequence Chart, and the aircraft has been removed from the Assembly Building to the Paint Facility.

PBP Event Completion Criteria Dilemma

- Regulation:“The contracting officer shall not approve a performance-based payment until the specified event or completion criterion has been successfully accomplished in accordance with the contract.” [FAR 32.1007(d)]

<u>But how does one determine completeness?</u>

Establishing PBP Event Completion Criteria

- To establish successful PBP event completion criteria, one must:
  - Understand product and processes
  - Include clear and thorough description of event “completeness” in the contract
  - Be flexible in development of completion criteria

Meet Completion Criteria

Successful completion of payment event is demonstrated by meeting predetermined criteria:

- Contractor substantiates that payment event has been met in such detail as requested by contracting officer
- Contracting officer verifies completion using on site physical inspection, and/or contractor's documentation

Completion Criteria

- Example: Payment event completion criteria

  Payment No. 1- Aircraft enters Paint. This event is complete when aircraft assembly requirements have been completed at Aircraft Production Flow-Position One (1), per the Contractor's Major Assembly Sequence Chart, and the aircraft has been removed from the Assembly Building to the Paint Facility.

Completion Criteria: Simple

- Event : APU Engine Delivery

- Completion Criteria: Delivery of APU Engine to Prime Contractor. The APU Engine must be delivered and accepted defect free.

Completion Criteria: Complex

- Event: Belly Skins & 820 Bulkhead Complete
- Completion Criteria: Remove skins 11 L&R and 18 L&R. Repair and/or replace substructure as required . Reinstall skins 11 L&R and 18 L&R. Remove and replace (R&R) left and right station 820 bulkhead fitting in accordance with Service Bulletin (SB) 2912 if required. Skins 11 L&R & 18 L&R must be removed and reinstalled permanently, cargo doors and landing gear must be removed. Event 1 shall be complete. (Cumulative Event)

Completion Criteria: Complex

- Event: Receipt Of All Production Material

- Completion Criteria: All production material will be considered received when the longest lead time part, Decoder, Part # X11115AC, has been received or is being reported as “Late” on the weekly Material Action Report.

Completion Criteria: Inflexible

- CLIN 0001, Event #2, Receive Material
  - Event Completion Criteria: Receipt of 6000 pieces for truck manufacture verified
    - NOTE: Of 6000 separate pieces, 150 constitute 85% of value

Event #1: Materials Handling (Place PO's)

Event #2: Receive Material

Event #3: Assembly Complete

DD250

Criteria Lessons Learned

- It is critical that DCMA be involved in the pre-award process in establishing the events and completion criteria

- Event completion criteria should be clearly defined, measurable, verifiable, and flexible

Recap - What We Learned

- Consider three PBP areas together (payment event, completion criteria, value of the event)
- Select good payment events
- Set clear, verifiable, and flexible (when appropriate) completion criteria
- Work as a team

Reminder: What We Are Learning

- Three key PBP areas
  - Establishing the payment events
  - Establishing the criteria for successful completion of the payment events
  - Reaching agreement on the value of payment events
- Next: How to set the appropriate value for a payment event

Establishing PBP Event Values

PBP event values should be established so as to:

- Provide adequate cash flow

AND

- Be proportionate to value of completed event

Event Value Rules and Restrictions

- Amounts “shall be provided only to the extent actually needed for prompt and efficient performance” [FAR 32.104(a)(1)]

- Amounts may be based upon;
  - Whole contract or
  - Specific line item(s)

Event Value Rules and Restrictions (cont'd)

- Payment amount must be clearly defined in contract
  - It is provided as dollar value or percentage of known amount, e.g., unit price
    [FAR 32.1004(b)(3)]

Event Value Rules and Restrictions (cont'd)

- Per FAR 52.232-28, amount is limited to:
  - 90% of contract price, if on whole contract basis
  - 90% of delivery item price, if on delivery item basis

Event Value Rules and Restrictions (cont'd)

- When performance-based finance amount is established on deliverable line item basis, each event or completion criterion:
  - Must be part of performance necessary for that deliverable item
  - Must be identified to specific contract line or subline item

Event Value Rules and Restrictions (cont'd)

- All payment amounts must provide for liquidation upon delivery
- Payment requests can only be submitted once in any given month
  - Each request can, however, cover payment for multiple events

Event Value Rules and Restrictions (cont'd)

- Use a rational basis to achieve reasonable PBP values, such as:
  - Engineering estimates of stages of completion
  - Engineering estimates of hours or other measures of effort to be expended in performance of an event
  - Estimated projected costs of performance of events
  - Overall relative weighted percentage of completion

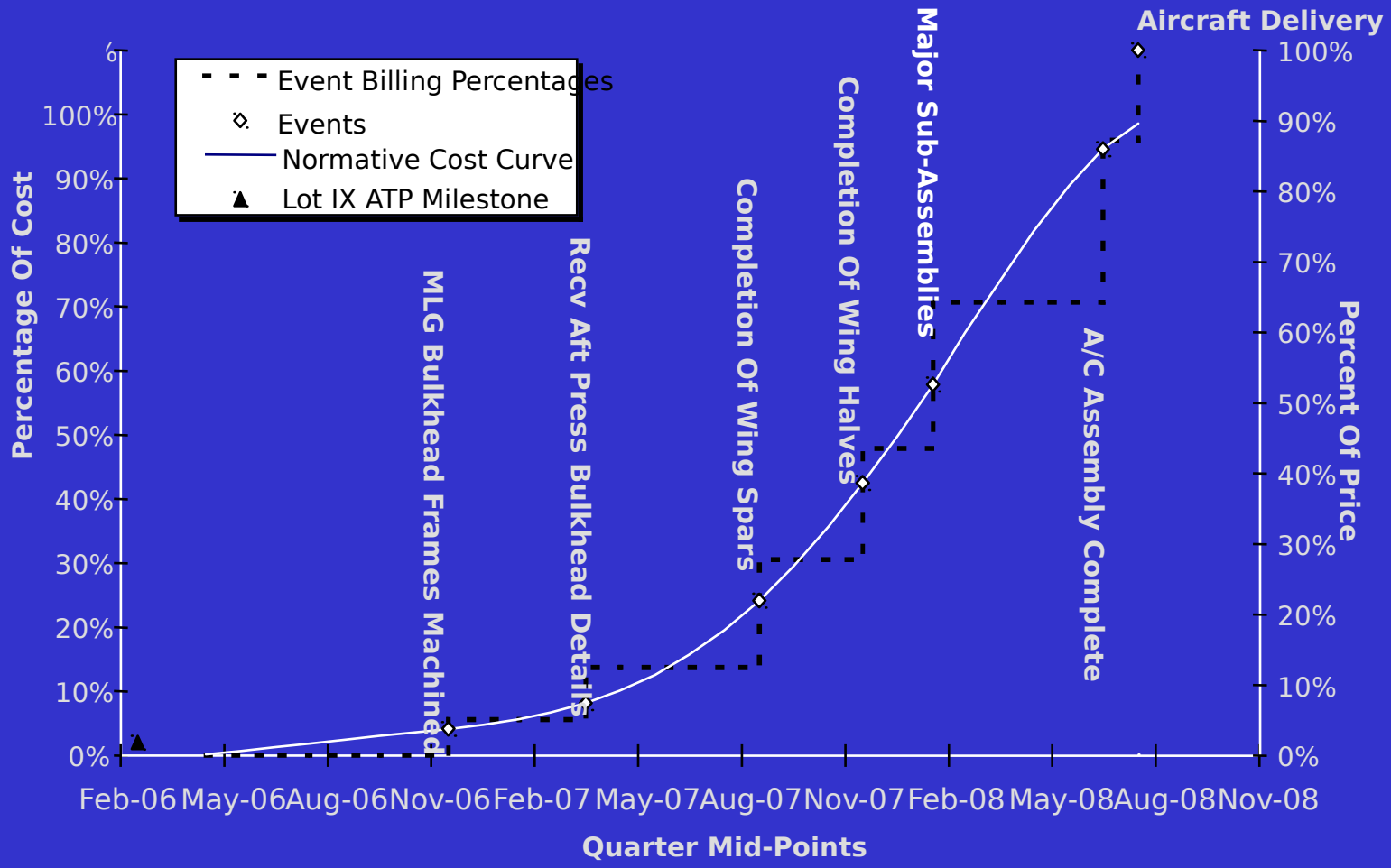
Event Value Rules and Restrictions (cont'd)

- Schedule and amounts to be financed must take into account value of work actually completed and protect the Government's interests

Establishing PBP Event Values

Notional Aircraft Cost Profile

Performance Events With PBP Billing Percentages



Establishing PBP Event Values

- **CLIN 0001 - Manufacture of Medium Trucks**

Event #1 Material Handling: (PO's Placed)

Event #2 Recv Matl

Event #3 Assembly Complete

DD250

CONTRACT PRICE		CONTRACT FINANCING		DELIVERY
PAYMENT	Est. Price	PBP Payment		
Matl Handling	**$60,000**	**Event #1**	**$54,000**	**Delivery Inv**
Matl Receipt	**$750,000**	**Event #2**	**$675,000**	**$1,710,000**
Labor	**$900,000**	**Event #3**	**$810,000**	**Unliq PBPs -**
Total FFP -	**$1,710,000**	**Total PBPs**	**$1,539,000**	**$1,539,000**
		(= 90% PBP rate)		**DD250 Pmt**
				$171,000
				(90% liquidation rate)

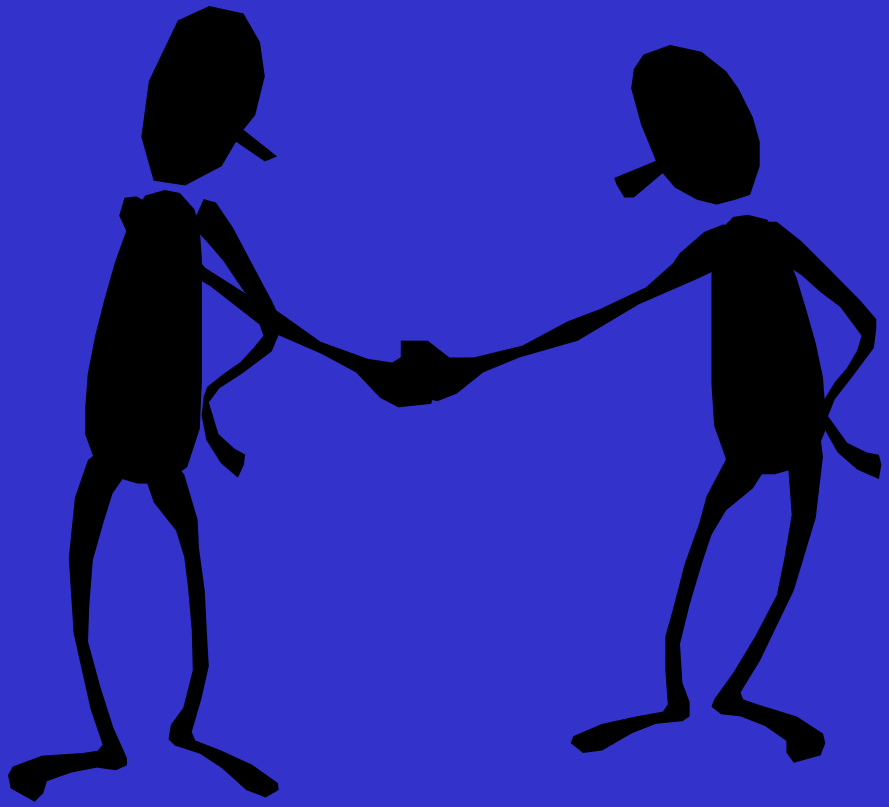
Establishing Liquidation Terms

- FAR Subpart 32.1004(d)
  - Performance-based financing payments must be liquidated by deducting either a percentage or a designated dollar amount from delivery payments

Establishing Liquidation Terms (cont'd)

- Contracting officer must specify liquidation rate or designated dollar amount in the contract
  - If PBPs are established on a delivery item basis, liquidation amount of each line item is a percentage of that delivery item price or a designated dollar amount
  - If PBPs are established on a whole contract basis, liquidation is by a predesignated liquidation amount or percentage

Team Effort!



What We Learned

- There are three key PBP areas:
  - Establishing the payment events
  - Establishing the criteria for successful completion of the payment events
  - Reaching agreement on the value of payment events
- Performance-based payments (PBPs) must provide contractor with adequate cash flow
- At the same time, the value of the completed event should be proportionate to the financing provided